

## Message Text

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INFO OCT-01 EA-06 ISO-00 CIAE-00 DODE-00 PM-03 H-01 INR-07

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AID-05 CEA-01 COME-00 EB-07 FRB-03 IO-10 NEA-09

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INFO AMEMBASSY BERN

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E. O. 11652: N/A

TAGS: EFIN, OECD

SUBJECT: EPC'S WORKING PARTY 3 MEETING, MARCH 5, 1975

REFS: (A) CPE/WP3(75)1

(B) CPE/WP3(75)2

(C) CPE/WP3(75)3

(D) CPE/WP3(75)4

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1. SUMMARY: FULL DAY OF ACTIVE DEBATE LED WP-3 TO SERIES OF BROAD OBSERVATIONS WIDELY, ALTHOUGH IN SOME CASES NOT UNANIMOUSLY SHARED:

- (A) CURRENT ACCOUNT DEFICIT OF GROUP IN 1975 LIKELY TO BE SIGNIFICANTLY LESS THAN EARLIER ESTIMATES.
- (B) SOME PROGRESS BEING MADE IN REDUCING MOST TROUBLESOME DEFICITS (I.E. ITALY AND DENMARK) BUT MUCH OF IMPROVEMENT COMING IN "WRONG" PLACES (I.E. GERMANY, NETHERLANDS AND JAPAN).
- (C) PROSPECTS FOR U.S. DOLLAR SOMEWHAT MORE REASSURING CONSIDERING STATEMENT BY U.S. DEL.
- (D) NEITHER A RETURN TO PAR VALUES NOR ESTABLISHMENT OF TARGET ZONES FOR EXCHANGE RATES IS FEASIBLE.
- (E) INTEREST RATE DIFFERENTIALS HAVE BEEN A SIGNIFICANT FACTOR IN DETERMINING EXCHANGE RATE PRESSURES.

U.S. DEL (BENNETT) GAVE DETAILS AND EXPLANATION OF RECENT WEAKNESS OF DOLLAR IN FOREIGN EXCHANGE MARKETS AND REJECTED CHARGE OF "BENIGN NEGLECT" WHILE REAFFIRMING SUPPORT OF BASIC FLOATING SYSTEM. SECRETARIAT CHARGED WITH PREPARING PAPER ON QUESTION OF MEDIUM-TERM BALANCE-OF-PAYMENTS OBJECTIVES IN RESPONSE TO UK REQUEST. NEXT MEETING AFTERNOON MAY 14 AND MAY 15, WITH AGENDA TO INCLUDE (A) FURTHER CONSIDERATION OF EXCHANGE RATE SITUATION, (B) FEASIBILITY OF DEVELOPING MEDIUM-TERM OBJECTIVES TO AID IN JUDGING APPROPRIATENESS OF COUNTRIES' POLICIES, AND (C) INSTRUMENTS FOR ACHIEVING BETTER PAYMENTS ADJUSTMENT AMONG OECD COUNTRIES. END SUMMARY.

2. SECRETARIAT REPORTED THAT OECD CURRENT ACCOUNT DEFICIT FOR 1975 NOW ESTIMATED AT \$27.5 BILLION WITH OPEC COUNTRIES EXPECTED SHOW SURPLUS OF \$53 BILLION, IMPLYING DEFICIT OF \$25 BILLION IN REST OF WORLD. REDUCTION IN REPORTED OECD DEFICIT AND OPEC SURPLUS ATTRIBUTED PRIMARILY TO CYCLICAL WEAKNESS OF OECD ECONOMIES. PROJECTION ASSUMED NO CHANGE IN REAL PRICE OF OIL. ONLY QUESTION RE OVERALL FIGURES WAS RAISED BY LIMITED OFFICIAL USE

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IMF (SCHWARZ), WHO SAID THAT IMF ESTIMATE OF OPEC SURPLUS FOR 1975 LIKELY TO BE JUST AT \$59 BILLION OR LESS (TRANSACTIONS BASIS). SCHWARTZ THOUGHT LDC DEFICIT IN 1975 WOULD BE AT LEAST \$33 BILLION AND FORESAW VERY DIFFICULT POSITION FOR LDC'S.

3. MOST WP DELEGATIONS ACCEPTED SECRETARIAT ESTIMATES FOR THEIR OWN COUNTRIES EXCEPT FOR GERMANS, WHO EXPECT

SUBSTANTIALLY SMALLER SURPLUS, AND U. S. WHICH EXPECTS  
SOMEWHAT LARGER DEFICIT (\$5 TO \$7 BILLION) IN LARGE  
PART AS RESULT IN FALL OF OIL INVESTMENT INCOME.  
SWEDES REPORTED FORECAST OF \$4.5 BILLION DEFICIT FOR  
SWEDEN, NORWAY AND DENMARK COMBINED.

4. ALL DELS CONSIDERED PROSPECTIVE 1975 DEFICITS  
MANAGEABLE, ALTHOUGH UK AND DENMARK ACKNOWLEDGED  
POSSIBILITY OF FINANCING PROBLEMS. ITALIANS (IZZO  
AND MAGNIFICO) DREW ATTENTION TO VERY SHARP REDUCTION  
IN DEFICIT SINCE MID-1974 AND 1975 ESTIMATE OF \$3.8  
BILLION DEFICIT DESPITE OIL IMPORT BILL OF \$7 BILLION,  
INDICATED CONFIDENCE. IMPORT DEPOSIT SCHEME AND  
"CREDIT CRUNCH" GIVEN MAJOR SHARE OF CREDIT, ALONG  
WITH SOME IMPROVEMENT IN TERMS OF TRADE.

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5. INDIVIDUAL COMMENTS SUGGESTED SOME CONCERN OVER UK POSITION WITH LARGEST DEFICIT IN PROSPECT (\$7.5 BILLION), HIGHEST INFLATION RATE AND LEAST SLACK IN DOMESTIC ECONOMY. UK DEL (FOGARTY) IMPLIED PROSPECTS HEAVILY DEPENDENT ON ADOPTION OF EXPANSIONARY POLICIES BY LIMITED OFFICIAL USE

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TRADING PARTNERS.

6. WP CLEARLY DISTURBED BY PROSPECTIVE GERMAN SURPLUS, WHETHER \$12 BILLION AS SECRETARIAT PREDICTED OR SIGNIFICANTLY LESS AS PREDICTED BY GERMANS (POEHL). POEHL ARGUED THAT HIGHLY EXPANSIONARY POLICIES (BUDGET DEFICIT--ALL LEVELS OF GOVERNMENT EXCEEDING 5 PERCENT OF GNP -- AND MONETARY AGGREGATES EXPANDING 8 PERCENT WOULD REDUCE SURPLUS IN TIME. EXPORT ORDERS ALREADY FALLING. ALSO CITED SUBSTANTIAL DM APPRECIATION IN LAST TWO YEARS, SUGGESTING THAT ANY FURTHER APPRECIATION WOULD BEGIN TO PUSH GERMAN EXPORTERS INTO DIFFICULTIES SUCH AS FACED NOW BY KEY SWISS EXPORTERS.

7. JAPANESE (YOSHIDA) PREDICTED FURTHER GRADUAL STRENGTHENING OF JAPAN'S CURRENT ACCOUNT POSITION AFTER 1975 DESPITE SUBSTANTIAL--BUT UNANNOUNCED--STEPS ALREADY TAKEN, AND LIKELIHOOD OF FURTHER MEASURES AFTER APRIL WAGE SETTLEMENTS TO REVIVE DOMESTIC ECONOMY. YOSHIDA DID NOT DESCRIBE THE UNANNOUNCED STEPS TAKEN.

8. FRENCH (BLOCH-LAIHE) SAID FRANCE INTENDED ELIMINATE CURRENT ACCOUNT DEFICIT BEFORE 1980 AND ACHIEVE SURPLUS IN 1980 IN ORDER MINIMIZE AND SUBSEQUENTLY REDUCE BUILD-UP OF DEBT WHICH GOVERNMENT CONSIDERED VERY SERIOUS.

9. IN RESPONSE TO CHAIRMAN'S QUESTIONS CONCERNING CAUSE OF "SO-CALLED" WEAKNESS OF DOLLAR, BENNETT

REMINDED WP THAT DOLLAR HAD SHOWN LESS INSTABILITY OVER LAST TWO YEARS THAN NUMBER OF OTHER CURRENCIES, THAT IT WAS EVEN NOW ABOVE MID-1973 LOW POINT, AND VIRTUALLY SAME LEVEL AS SPRING OF 1974, WITH WEAKENING SINCE LAST SEPTEMBER MERELY REVERSING STRONG UPTURN OF PREVIOUS MONTHS. BENNETT CITED CAUSE OF RECENT WEAKNESS AS:

- (A) DIVERSIFICATION OF INVESTMENT BY OPEC AND UNDERESTIMATE BY SOME OF SCOPE FOR DIVERSIFICATION
- (B) CONCERN ABOUT POLITICAL INSTABILITY IN LIMITED OFFICIAL USE

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MIDDLE EAST

- (C) U. S. LEAD IN REDUCTION OF INTEREST RATES
- (D) DETERIORATION OF U. S. CURRENT ACCOUNT POSITION, COMPARED TO TRENDS IN SOME OTHER COUNTRIES
- (E) RECOGNITION OF BETTER ANTI-INFLATIONARY PERFORMANCE IN GERMANY AND SWITZERLAND
- (F) FEAR THAT EXPANSIONARY POLICIES MIGHT LEAD RESURGENCE OF INFLATION
- (G) SECONDARILY, OPEC EXPRESSIONS OF CONCERN AND TALK OF PRICING OIL IN A COCKTAIL OF CURRENCIES

10. BENNETT NOTED NUMBER OF FACTORS RELEVANT TO FUTURE OF DOLLAR:

- (A) U. S. ENCOURAGING OPEC TO CONTINUE TO INVEST IN DOLLARS IN U. S. (THROUGH BILATERAL CONVERSATIONS, ADMINISTRATION OPPOSITION TO LEGISLATION CALLING FOR SCREENING AND NO INTENTION OF IMPOSING CAPITAL CONTROLS)
- (B) SOME IMPROVEMENT IN OUTLOOK FOR POLITICAL STABILITY IN MIDDLE EAST
- (C) U. S. LEAD IN DOWNWARD TREND OF INTEREST RATES ENDING AND RATES LIKELY TO TURN UP IN FUTURE AS DOMESTIC DEMAND STRENGTHENS
- (D) RESIDUAL EFFECTS OF PAST DEVALUATIONS STILL WORKING THROUGH SYSTEM
- (E) BETTER U. S. PERFORMANCE ON INFLATION THAN MOST OTHER COUNTRIES.

11. BEHNETT ADDED THAT CHARGE OF "BENIGN NEGLECT" WAS MISLEADING. SOLOMON POINTED OUT THAT CONCERN FOR INTERNATIONAL IMPLICATIONS WAS FACTOR IN CAUTIOUS MOVES BY FED TOWARD MONETARY EXPANSION. BENNETT

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OBSERVED THAT U. S. HAD LITTLE FLEXIBILITY IN  
ATTEMPTING TWIST DOMESTIC POLICIES TO ACHIEVE  
PARTICULAR EFFECT ON EXCHANGE RATE IN CURRENT  
SITUATION. INTERVENTION WOULD CONTINUE TO BE  
DESIGNED TO AVOID DISORDERLY CONDITIONS AND  
NOT TO AIM AT ANY PARTICULAR TARGET EXCHANGE

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RATE.

12. FINALLY, BENNETT EXPRESSED STRONG CONCERN THAT MAMMOTH CREDITS TO EASTERN EUROPE AT LOW INTEREST RATES AND UK ACTION IN JOINING FRENCH IN PROTECTING EXPORTERS AGAINST RISK OF INFLATIONARY COST INCREASES WOULD ENDANGER EFFORT TO GET AGREEMENT TO LIMIT INTERNATIONAL CREDIT RACE. HE WARNED WP THAT U. S. WOULD "MEET THE EXPORT CREDIT COMPETITION."

13. OTHER DELS STRESSED INTEREST RATE SITUATION AND OPEC DIVERSIFICATION AS BASIC CAUSES OF RECENT EXCHANGE RATE MOVEMENTS. SOME FELT OPEC WOULD HAVE NO ALTERNATIVE TO PLACING MORE MONEY IN U. S., OTHERS STRESSED NEED FOR SHIFTS IN MONETARY POLICY TO ALTER INTEREST RATE DIFFERENTIALS, WITH SECRETARIAT NOTING THAT THIS PRESUMABLY WAS CALL FOR LOWERING OF RATES IN EUROPE.

14. SWISS (HAY) ELABORATED ON GREAT DIFFICULTIES RATE MOVEMENT HAD CREATED FOR SWISS EXPORT INDUSTRIES AND BEMOANED INEFFECTIVENESS OF NEGATIVE INTEREST RATE AND OTHER RESTRICTIVE ACTIONS. SAID AUTHORITIES WERE CONSIDERING MODIFYING INTERVENTION POLICY TO MAINTAIN COMPETITIVE POSITION VIS-A-VIS MAJOR EUROPEAN NEIGHBORS WITHOUT JOINING "SNAKE." BELGIANS (JANSON) OFFERED BITTER REMARK THAT TRADE PLEDGE HAD NO MEANING IF COUNTRIES WERE FREE TO UNDERCUT IT BY EXCHANGE RATE CHANGES, AND CALLED ON U. S. TO RAISE INTEREST RATES OR IMPOSE CAPITAL CONTROLS. OTHER DELS APPEARED TO SHOW GREATER UNDERSTANDING OF U. S. SITUATION.

15. ON SCOPE FOR SURPLUS COUNTRIES TO INCREASE EXPANSIONARY MEASURES, OORT SAID NATURAL CONSTRAINTS APPLIED TO THE MEASURES THAT COULD BE TAKEN. WITH PRIVATE INVESTMENT EXPENDITURES VERY DEPRESSED AND THE STIMULUS COMING FROM PUBLIC EXPENDITURES RELATIVE LARGE, ONE MIGHT RUN INTO OVERHEATING ONCE PRIVATE INVESTMENT TURNED UP AGAIN. SURPLUS COUNTRIES SHOULD NOT INFLATE THEMSELVES INTO EQUILIBRIUM WITH THE REST

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OF THE WORLD--EXPANSIONARY MEASURES SHOULD BE TAKEN

WITH REASONABLE CONSTRAINTS. QUERIED ABOUT POSSIBILITY FOR INSTITUTION OF TEMPORARY TAX RELIEF, OORT REPLIED THAT POLITICAL REALITIES MADE IT VERY DIFFICULT TO REVERSE TAX RELIEF MEASURES FOR CYCLICAL REASONS. THIS WAS SUPPORTED BY EMMINGER AND PUT THE DUTCH AND GERMANS IN JUXTAPOSITION WITH BRITISH AND SECRETARIAT, WHO BELIEVE THAT IT IS DIFFICULT TO MAKE RAPID ADJUSTMENTS IN PUBLIC EXPENDITURES FOR CYCLICAL REASONS.

16. BRITISH, IN ADVANCE OF MEETING, HAD CIRCULATED PROPOSAL CALLING FOR AGREEMENT ON POLICIES TO ACHIEVE BETTER DISTRIBUTION OF OECD DEFICIT, GIVEN FACT THAT DIRECTION OF NEEDED ADJUSTMENT FOR MOST COUNTRIES WAS CLEAR. UK DEL EXPANDED THIS CONCEPT TO INCLUDE DEFINITIONS OF MORE PRECISE MEDIUM-TERM BALANCE OF PAYMENTS TARGETS. THERE WAS NO COMMENT FROM OTHER DELS. CHAIRMAN REQUESTED SECRETARIAT TO PREPARE PAPER IN CONJUNCTION WITH NATIONAL EXPERTS DETAILING WHETHER SUCH AN APPROACH WAS FEASIBLE AND HOW IT MIGHT WORK. SECRETARIAT WILL BEGIN BY ASKING EACH MEMBER COUNTRY TO GIVE SPECIFIC PROJECTION ON THE MEDIUM-TERM EVALUATION OF ITS BALANCE OF PAYMENTS. TURNER

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## Message Attributes

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**Capture Date:** 01 JAN 1994  
**Channel Indicators:** n/a  
**Current Classification:** UNCLASSIFIED  
**Concepts:** MEETING AGENDA, COMMITTEE MEETINGS, ECONOMIC POLICIES, DEVELOPMENT FINANCE, MEETING REPORTS  
**Control Number:** n/a  
**Copy:** SINGLE  
**Draft Date:** 07 MAR 1975  
**Decaption Date:** 01 JAN 1960  
**Decaption Note:**  
**Disposition Action:** RELEASED  
**Disposition Approved on Date:**  
**Disposition Authority:** GolinoFR  
**Disposition Case Number:** n/a  
**Disposition Comment:** 25 YEAR REVIEW  
**Disposition Date:** 28 MAY 2004  
**Disposition Event:**  
**Disposition History:** n/a  
**Disposition Reason:**  
**Disposition Remarks:**  
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**Document Source:** CORE  
**Document Unique ID:** 00  
**Drafter:** n/a  
**Enclosure:** n/a  
**Executive Order:** N/A  
**Errors:** N/A  
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**Original Classification:** LIMITED OFFICIAL USE  
**Original Handling Restrictions:** n/a  
**Original Previous Classification:** n/a  
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**Page Count:** 8  
**Previous Channel Indicators:** n/a  
**Previous Classification:** LIMITED OFFICIAL USE  
**Previous Handling Restrictions:** n/a  
**Reference:** 75 CPE/WP3(7  
**Review Action:** RELEASED, APPROVED  
**Review Authority:** GolinoFR  
**Review Comment:** n/a  
**Review Content Flags:**  
**Review Date:** 15 APR 2003  
**Review Event:**  
**Review Exemptions:** n/a  
**Review History:** RELEASED <15 APR 2003 by ShawDG>; APPROVED <16 APR 2003 by GolinoFR>  
**Review Markings:**

Margaret P. Grafeld  
Declassified/Released  
US Department of State  
EO Systematic Review  
05 JUL 2006

**Review Media Identifier:**  
**Review Referrals:** n/a  
**Review Release Date:** n/a  
**Review Release Event:** n/a  
**Review Transfer Date:**  
**Review Withdrawn Fields:** n/a  
**Secure:** OPEN  
**Status:** NATIVE  
**Subject:** EPC'S WORKING PARTY 3 MEETING, MARCH 5, 1975  
**TAGS:** EFIN, ECON, OECD, EPC  
**To:** STATE  
**Type:** TE  
**Markings:** Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 05 JUL 2006